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Audit Report No. 04-002

The FDIC's 2003 Service Line Rates

AUDIT REPORT

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Office of Audits
Office of Inspector General

DATE: January 15, 2004

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SUBJECT: *The FDIC's 2003 Service Line Rates* (Audit Report No. 04-002)

This report presents the results of the Federal Deposit Insurance Corporation (FDIC) Office of Inspector General's (OIG) audit of the FDIC's development of service line[1] rates for calendar year 2003. The FDIC uses service line rates to bill FDIC receiverships[2] for administrative expenses incurred by the FDIC that cannot be readily attributed to a specific receivership. Service line rates for 2003 were developed by the Director, Division of Resolutions and Receiverships (DRR), and were submitted on March 13, 2003 for approval. The service line rates were approved by the Deputy to the Chairman and Chief Financial Officer on March 19, 2003.

The objective of this audit was to assess the adequacy of the FDIC's process for developing its 2003 service line rates for the Service Costing Billing System (SCBS).[3] Specifically, we determined whether 2003 service line rates were fair and reasonable, accurately calculated, and adequately supported. Although the FDIC uses service line rates as a cost accounting tool, the audit focused on the FDIC's use of service line rates to calculate receivership billings. From January 1, 2003 to October 31, 2003, the FDIC billed 120 receiverships a total of $33,142,476 using the approved FDIC service line rates. Additional details on our objective, scope, and methodology are presented in Appendix I.

[1] Service lines group services performed by the FDIC in the management and liquidation of failed financial institutions into similar line items by the type of service that is performed.
[2] Receiverships are failed financial institutions for which the FDIC has been appointed as receiver to manage the liquidation (asset sales, loan servicing, claims resolution, etc.) of the institution's remaining assets.
[3] The SCBS is the billing component of the Service Costing System used by the Division of Finance to capture and report budgeted and actual expense data for the FDIC. The SCBS applies standard rates to workload volumes extracted from various FDIC data systems to calculate total charges to receiverships for services provided by the FDIC.

BACKGROUND

When an FDIC-insured institution fails or is closed by a federal or state regulatory agency, the FDIC is appointed as receiver. The FDIC's Receivership Management Program, one of the FDIC's three main business lines, includes performing the closing function at the failed institution, maintaining the value of and liquidating any remaining failed institution assets, and distributing any proceeds of the liquidation to those with approved claims of the receivership.

When the FDIC incurs expenses on behalf of a receivership, the FDIC charges these expenses directly to the receivership. For example, the FDIC may bill receiverships directly for contractor personnel, equipment, and certain travel costs for work that is attributable to a particular receivership. However, many expenses incurred by the FDIC cannot be attributed directly to a single receivership. The FDIC implemented the SCBS in January 2002, using service line rates as a mechanism to bill the active[4] receivership population for these expenses. The FDIC is authorized under Section 11 of the FDI Act, codified to 12 U.S.C. §1821(d)(11), to use amounts realized from the liquidation or other resolution of any insured depository institution to pay administrative expenses of the receiver. Section 12 of the Code of Federal Regulations (12 C.F.R. §360.4), which implements 12 U.S.C. §1821(d)(11), requires the FDIC to charge only those expenses that are "necessary and appropriate" to receiverships (see Appendix I). This regulation also gives the FDIC discretion in determining expenses that are billable.

Service Line Rates

Service line rates are developed on a variety of bases (per hour, per unit, etc.), depending on the service line billing drivers.[5] For the 2003 billing year, the FDIC refined service lines and related billing drivers that had been established in 2002 and established new rates. As shown in table 1, the 2003 service lines include: franchise marketing, customer service, valuation, closing, financial services, asset sales, subsidiaries management, asset management, litigation, receivership claims, and receivership oversight. Five of the 2003 service lines were further divided into subservice lines, resulting in a total of 21 billing rates.

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[4] Active receiverships are those in the process of being liquidated. Once the receivership has been substantially liquidated, it is placed in terminated status and becomes inactive. Inactive receiverships are not billed for administrative expenses.

[5] Billing drivers are the units of measure used to determine the volume of activity for a particular service line such as number of hours worked, number of claims processed, or number of sales transactions.

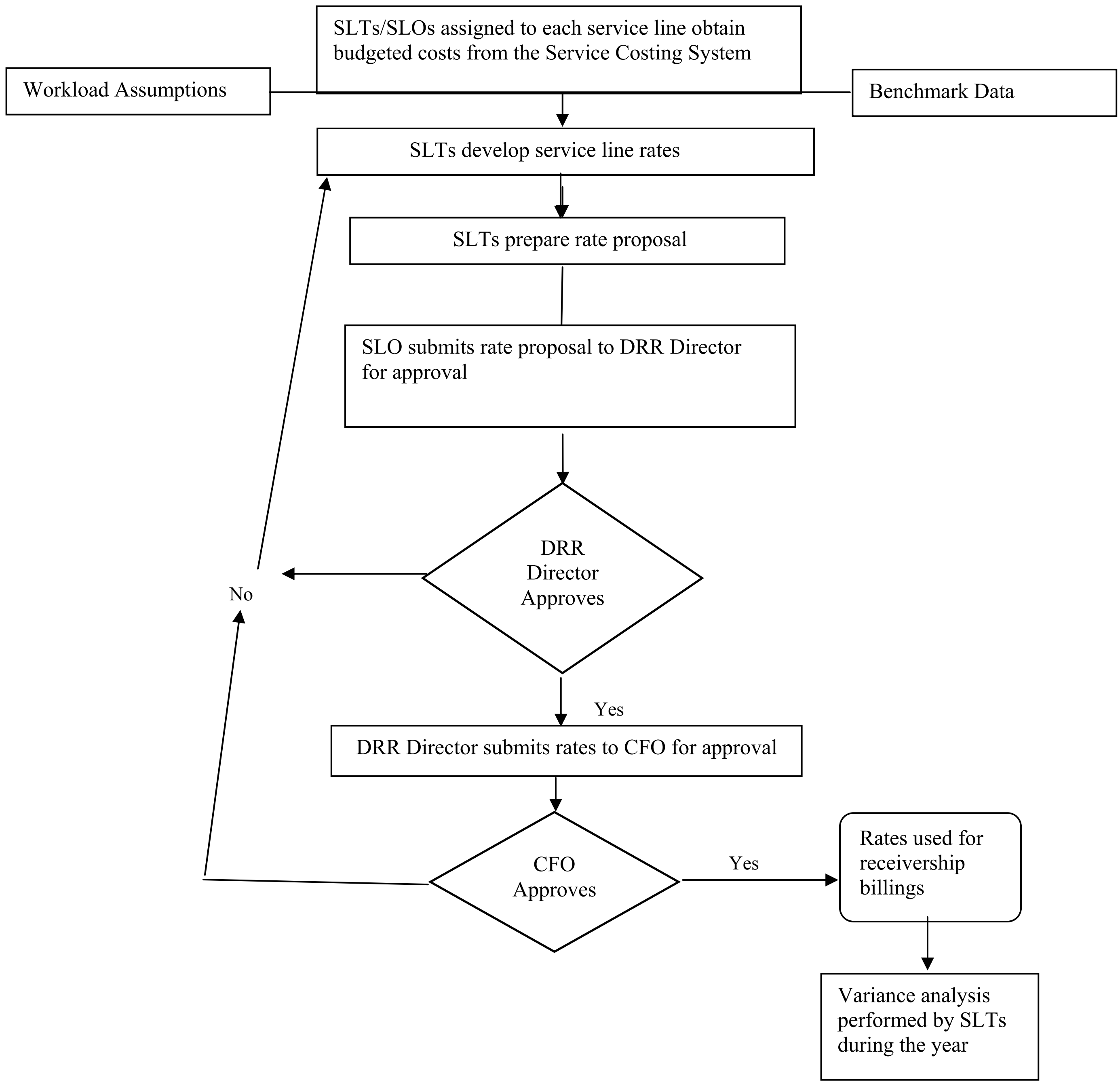
Table 1: 2003 Service Lines and Related Billing Drivers and Rates

Service Line	Billing Driver	Service Line Rate
Franchise Marketing	Percent of Sales Price	10 percent to first million 8 percent to second million 6 percent to third million 4 percent thereafter $50,000 minimum fee
Customer Service	One-Time Fee	Variable based on Dollar Value
Valuations	Labor Hours	$149 per hour
Closing Activities	Labor Hours	$124 per hour
Financial Services	Labor Hours	$135 per hour
Asset Sales		
Loan Sales	Basis Points per Sale	58 Basis Points
Owned Real Estate Sales	Basis Points per Sale	504 Basis Points
Security Sales	Percent of Sales Price	50 Basis Points
Other Asset Sales/Managed	Percent of Sales Price	118 Basis Points
Subsidiary Management	Labor Hours	$147 per hour
Asset Management		
Loans Managed	Percent of Outstanding Balance	6.25 percent
Owned Real Estate Managed	Flat fee per Property	$1,000 per Property
Securities Managed	Percent of Outstanding Balance	1.75 percent
Contract Oversight	Percent of Invoice to Receivership	10.50 percent
Litigation/Investigations		
Receivership Litigation	Labor Hours	$189 per hour
Investigations	Labor Hours	$136 per hour
DIR Research	Labor Hours	$105 per hour
Receivership Claims		
Asset Claims	Per Claim Processed	$315 per claim
Other Receivership Claims	Per Claim Processed	$2,815 per claim
Oversight Operations		
Receivership Oversight	Labor Hours	$138 per hour
Employee Benefits	Number of Participants	$34 per participant

Source: FDIC 2003 Service Line Rates Memorandum dated March 13, 2003.

Figure 1 below depicts the FDIC's rate-setting process. Each service line is assigned a Service Line Team (SLT) and is managed by a Service Line Owner (SLO). The SLTs are responsible for developing service line rates for their respective service line.

Figure 1: Service Line Rate-Setting Process Flowchart



Source: FDIC Budget and Business Planning Procedures.

SLOs are in DRR with the exception of the Litigation SLO who is in the Legal Division. The SLO is responsible for coordinating and managing the activities of the service line including proposing service line workload assumptions, budgets, and service line rates to the DRR Director. The DRR Director approves the proposed service line rates and submits them to the FDIC Chief Financial Officer for approval. After receiving the Chief Financial Officer's approval, the service line rates are programmed into the SCBS for use during the calendar year.

The Division of Finance (DOF) uses the Service Costing System to capture and report budgeted and actual expense data for the FDIC. DOF makes service line workload and expense information from this system available to the SLTs on a monthly basis. To support FDIC quarterly variance reporting requirements, the SLTs provide a summary of the quarterly and year-to-date variance activity for their respective service lines to the affected FDIC division directors. The SLTs must also evaluate variances between budgeted and actual workload and between forecasted and actual receivership billings. Each month, DOF uses the service line rates to calculate receivership bills. The service line rates are multiplied by the related service line workload driver. For example, a monthly charge for asset claims activity would be calculated by multiplying the service line rate of $315 by 100 asset claims processed on behalf of that receivership, resulting in a total bill of $31,500.

In preparation for establishing 2003 service line rates, the FDIC contracted with the American Productivity and Quality Center (APQC) of Houston, Texas. APQC conducted an assessment of FDIC service lines and benchmarks, taking into consideration known industry standards and practices. APQC established market-based benchmark rates for each service line based on surveys of, or interviews with, private-sector companies or through a process known as Activity Based Costing.[6] Activity Based Costing was used for those service lines for which adequate market-based benchmarks could not be established. APQC used Activity Based Costing to measure and then price out all the required resources used for activities that support the production and delivery of the service line products and services. One of the goals of the APQC effort was to assist in identifying justifiable and supportable benchmark rates for billing FDIC receiverships.

The FDIC also independently calculated service line rates based on budgeted cost. Specifically, DRR SLTs calculated budgeted rates for each service line by (1) taking the total budgeted amount for the respective service line, (2) subtracting costs that were billed directly to the receiverships, and (3) dividing that amount by the projected unit workload for the service line. DRR SLOs were then presented with the budgeted rates and the APQC-identified benchmark rates for review and comment. Based on input from the FDIC Legal Division, which advised DRR that it should not project a profit on any service line, DRR decided that the lower of the two rates would be used to calculate receivership bills for 2003.

The SLOs submitted their respective Service Line Rate Case memorandums to the DRR Director for review and signature. Each rate case provided a description of the service line, a discussion

[6] Activity Based Costing is a cost accounting process that measures and then "prices out" all the required resources used for activities that support the production and delivery of products and services to the FDIC internal and external customers related to a specific service line.

of the budgeted rate in comparison to the benchmark rate, and a rationale for the rate proposed. Also, if the SLO's submission proposed using the benchmark rate, the rate case explained that the difference between the projected recovery based on using the benchmark rate and the greater projected recovery based on using the budgeted rate was attributable, in part, to costs related to program maintenance activities.[7] Such program maintenance activities are deemed nonrecoverable from receiverships according to the FDIC's Cost Recovery Principles[8] (see Appendix II). Finally, the DRR Director submitted the rate cases to the FDIC Chief Financial Officer for approval, and the approved rates for each service line were programmed into the SCBS.

[7] Program maintenance relates to service line activities that, although essential to the effective overall operation of the Receivership Management Program, are not event-driven and are not as directly related to optimizing specific net cash flow recoveries for the receiverships. Examples of these activities are statutorily mandated services such as responding to Freedom of Information Act requests, General Accounting Office and OIG audits, requests for information from the Congress and other government agencies, updating policies and procedures, and activities related to keeping the Receivership Management Program prepared to handle future workload.

[8] The FDIC's Cost Recovery Principles were presented by the Allocation and Recovery Task Force to the FDIC Operating Committee in March 1998. These principles identify certain expenses as not being chargeable to receiverships.

RESULTS OF AUDIT

The FDIC's process for developing service line rates for the SCBS has improved. During 2003, DRR refined service lines, improved service line benchmarks, and worked with DOF to improve the format of service line reports for SLOs. DRR is also working to improve procedures related to budget and business planning and the service costing rate-setting process. However, the 2003 service line rate methodology did not fully consider the impact that selecting a service line rate would have on receivership billings and cost recovery. Such a consideration would enhance the FDIC's ability to document that established rates were fair and reasonable. Specifically,

- DRR's methodology for establishing service line rates did not include an analysis of the variance in recovery depending on use of the benchmark rate or the budgeted cost rate. Consequently, the rate cases for 11 service lines did not justify the reason for service line cost recoveries that ranged from 5 to 95 percent of the service line budget when the benchmark rate was used. Further, service line rate cases did not adequately consider the effect of program maintenance costs on budgeted expenses. Therefore, nine budgeted rates used during 2003 included costs that the FDIC has deemed nonrecoverable from receiverships. Finally, the 2003 service line rate methodology was to ensure that no service line rate resulted in projected revenue in excess of the service line budget. However, excess revenue is projected in one service line, and the FDIC General Counsel has not formally opined on the issue of projecting such excess revenue (see Finding A: Service Line Rate Methodology).

- The Service Costing System has not provided SLOs with adequate cost model reports of actual expenses incurred by service line. Therefore, SLOs do not have all the necessary tools to effectively manage and analyze costs related to their respective service lines, and the SLOs are not able to adequately monitor receivership billings. Monitoring receivership billings is warranted given that receivership billings as of September 30, 2003, totaled $59,643,670 in comparison to actual costs of $153,919,414 for the Receivership Management Program (see Finding B: Other Service Line Rate-Setting Matters).

FINDINGS AND RECOMMENDATIONS

FINDING A: SERVICE LINE RATE METHODOLOGY

DRR's methodology for establishing 2003 service line rates did not fully consider the impact that selecting a service line rate would have on receivership billings and cost recovery. Specifically, DRR's methodology for establishing 21 service line rates did not require an analysis of: (1) the difference in recovery depending on use of the benchmark rate or the budgeted cost rate for 11 rate cases, (2) the effect of program maintenance costs for 9 rate cases, and (3) the potential for recovering greater than the budgeted cost for 1 rate case. Accordingly, the FDIC could improve the methods by which rates are determined to bill receiverships for administrative expenses that otherwise are paid by the insurance funds.

Benchmark and Budgeted Rates

The FDIC used two approaches for establishing its calendar year 2003 service line rates in an attempt to ensure that it set rates that were fair and reasonable. In one approach, the FDIC contracted with the APQC to provide expertise in developing benchmark service line rates that were supported by industry standards. Specifically, from February 2002 to March 2003, the APQC analyzed the FDIC's existing service lines, worked with FDIC SLTs to identify rates and benchmarks that could be validated with industry standards, conducted nationwide market research to develop benchmark rates, and conducted Activity Based Costing to measure and then price out service lines where market-based rates were not identifiable. The APQC ensured that the SLOs agreed that the benchmark rates were based on information that fairly represented the service line.

The FDIC also had its SLTs calculate the budgeted rates for each service line by using the total budget for each service line less directly billed expenses, divided by the projected workload for that service line. The service line budget and projected workload were based on information projecting failures and near failures of financial institutions provided by the FDIC's Division of Insurance and Research in consultation with DRR management.

DRR and DOF staff involved in the service line rate-setting process selected the lower of the two rates based on input from FDIC Legal Division counsel, which advised that no service line should project a profit by charging a benchmark rate that would recover more revenue than the budgeted service line cost. As shown in table 2 below, using the benchmark rate for 11 service lines resulted in the projected recovery of 5 to 95 percent of the related budgeted costs. However, the rate cases do not provide specific justification for the lower recovery resulting from use of the lower benchmark rate.

Table 2: Budgeted and Benchmark Recovery by Service Line

Service Line	Projected 2003 Recovery Using Budgeted Rate	Projected 2003 Recovery Using Benchmark Rate	Basis of Rate Used for 2003 Billings	Amount Not Recovered Using Benchmark Rate	Percentage Not Recovered
Franchise Marketing	$ 12,812,461	$ 10,262,350	Benchmark Rate	$ 2,550,111	20 percent
Customer Service	$ 8,273,424	$ 3,800,000	Benchmark Rate	$ 4,473,424	54 percent
Valuations	$ 13,195,008	$ 11,843,712	Benchmark Rate	$ 1,351,296	10 percent
Closing Activities	$ 8,179,509	$ 7,742,436	Benchmark Rate	$ 437,073	5 percent
Financial Services	$ 4,329,045	$ 4,906,251	Budgeted Rate	$ 0	-
Asset Sales					
Loans	$ 11,740,538	$ 36,031,307	Budgeted Rate	$ 0	-
Owned Real Estate	871,347	1,037,318	Budgeted Rate	0	-
Securities	2,013,368	1,006,684	Benchmark Rate	1,006,684	50 percent
Other Assets	3,122,620	49,750,223	Budgeted Rate	0	-
Subsidiary Management	$ 3,553,725	$ 3,650,425	Budgeted Rate	$ 0	100 percent
Asset Management					
Loans	$ 24,741,790	$ 8,379,000	Benchmark Rate	$16,362,790	66 percent
Owned Real Estate	5,361,090	5,772,000	Benchmark Rate	(410,910)[a]	-
Securities	3,542,460	182,280	Benchmark Rate	3,360,180	95 percent
Contract Oversight	4,182,126	205,752	Benchmark Rate	3,976,374	95 percent
Litigation/Investigations					
Receivership Litigation	$ 31,870,916	$ 38,907,352	Budgeted Rate	$ 0	-
Investigations	8,425,064	9,602,095	Budgeted Rate	0	-
DIR Research	117,915	117,915[b]	Budgeted Rate	0	-
Receivership Claims					
Asset Claims	$ 5,076,444	$ 1,049,265	Benchmark Rate	$ 4,027,179	79 percent
Other Receivership	5,371,621	4,287,245	Benchmark Rate	1,084,376	20 percent
Oversight Operations					
Receivership Oversight	$ 3,977,850	$ 4,352,575	Budgeted Rate	$ 0	-
Employee Benefits	563,760	532,440	Benchmark Rate	31,320	6 percent
Total	**$161,322,081**	**$203,418,625**		**$38,249,897**	**24 percent**

Source: Approved 2003 Service Line Rates Memorandum dated March 13, 2003.

[a] The Owned Real Estate Managed service line rate used the benchmark rate even though the benchmark rate was higher than the budgeted rate,as discussed in Finding A.

[b] A benchmark rate was not determined for Research due to the relatively small dollar value. For comparative purposes, the budgeted rate was used.

The FDIC's 2003 service line rate methodology ensured that the FDIC would not fully recover budgeted administrative expenses for those service lines for which the benchmark rate was lower than the budgeted rate. As a result, the FDIC projected that it would recover $38,249,897 less than the estimated budgeted cost for all the receivership service lines.

We fully acknowledge that there is nothing inherently wrong with the FDIC recovering $38 million less from receiverships than the estimated budgeted costs for all service lines. If such a difference is due to, for example, program maintenance cost, excess capacity, or the FDIC's own inefficiencies, the difference would be appropriate and fair to the receiverships and the insurance funds. However, when establishing a service line rate based on a benchmark rate that is significantly lower than the budgeted rate, the FDIC should make sure the rate is fair and reasonable for both the receiverships and the insurance funds. Further, analysis of the difference between projected budgeted costs and projected recovery would provide the FDIC greater support in justifying the rate-setting methodology in the event of litigation involving charges to the receiverships for administrative expenses.

Program Maintenance Costs

DRR's methodology for establishing service line rates did not provide adequate analysis of program maintenance costs. Consequently, 9 of the 21 service line rates are based on budgeted amounts that included costs for work that should not be billed to receiverships. Inherent in the work of each service line are costs deemed nonrecoverable under FDIC Cost Recovery Principles (see Appendix II). The FDIC Operating Committee has determined that costs related to program maintenance are not considered "necessary and appropriate" expenses and, therefore, should not be billed to the receiverships. Program maintenance activities include statutorily mandated services such as responses to Freedom of Information Act requests and General Accounting Office and OIG audits; requests for information from the Congress and other government agencies; updates of policies and procedures; and efforts to keep the Receivership Management Program prepared to handle future workload.

For 2002 receivership billings, the FDIC calculated service line budgeted rates by using the total budgeted cost for each service line less expenses billed directly to receiverships. The adjusted budgeted cost was then reduced by a standard 30 percent in an attempt to account for program maintenance costs. DRR SLOs stated that the 30-percent reduction used in 2002 was not specifically calculated for each service line. Rather, DRR management estimated that 30 percent was a reasonable estimate of the amount of work within the Receivership Management Program that was nonrecoverable under the FDIC's Cost Recovery Principles. However, DRR and DOF concluded that the 30-percent reduction used in the 2002 rate-setting process was not an adequate method for including program maintenance expenses in the rate case calculations because it was not based on supportable analysis of the actual program maintenance costs for the specific service lines.

For 2003, DRR did not apply a standard program maintenance reduction in calculating the budgeted cost for each service line. DRR staff explained that the FDIC does not currently have a mechanism in place to adequately capture program maintenance expenses. The rate cases for service lines for which the benchmark rate had been selected explained that the difference between the projected budgeted costs and the projected recovery using the benchmark rate was due in part to activities defined as program maintenance. As previously shown in table 2, the projected recovery ranged from 5 to 95 percent, depending on the service line. However, rate cases for the nine service lines for which the budgeted rate was selected did not discuss adjustments for program maintenance. Therefore, the budgeted rates used in 2003 included program maintenance costs that should not be billed to receiverships. Further, the rate cases showing that the benchmark rate had been selected did not provide a specific analysis to indicate how much of the difference related to program maintenance.

A comparison of two rate cases illustrates the inconsistency in the consideration of program maintenance costs among the service lines. For the Asset Claims service line, the FDIC selected the benchmark rate of $315 per claim over the budgeted rate of $1,524, resulting in a projected nonrecovery of $4,027,179 or 79 percent of the service line budget. The rate case explained that the difference between the benchmark rate and the budgeted cost related, in part, to program maintenance activities. For the Receivership Oversight service line, the benchmark rate of $151 was higher than the budgeted rate of $138; therefore, the budgeted rate was approved for this service line, resulting in a projected 100-percent recovery of the service line budget. However, this case did not discuss the impact of program maintenance costs on the service line.

The DRR decision to use the lower of the benchmark or budgeted rates was intended to establish rates that were supported either by industry standards or FDIC-budgeted costs. We recognize that DRR implemented such a methodology due to the advice of Legal Division counsel. However, in using the benchmark rates, we believe DRR should conduct an analysis during the rate-setting process to identify the reason for the selection of a rate that does not recover the service line budget. Using the benchmark rate without justifying the effect on the recovery of budgeted costs may not result in fair and reasonable billings for all service lines. A better approach would be for the SLTs to use the benchmark rate as a basis to support a proposed rate that is based on an analysis of the difference between the benchmark rate and budgeted cost recovery. Further, when budgeted costs are not adjusted for program maintenance expenses, service line budgeted rates may be based on costs that should not be recovered from receiverships.

Excess Revenue

The FDIC established one service line rate projected to generate billings in excess of the service line budget. The rate used for the Owned Real Estate Managed service line conflicted with the Legal Division's suggestion that projected revenue should not exceed the service line budgeted costs. For this rate case, the FDIC selected the benchmark rate even though it projected revenue in excess of the budgeted amount by $410,921. Specifically, the budgeted rate, based on the projected workload, was $929 per property. However, the benchmark rate of $1,000 per property was used for 2003. The rate case did not explain the reason for selection of the benchmark rate. DRR SLT members explained that although they did not technically follow the Legal Division's advice, they selected the benchmark rate because it was considered to be a defensible rate based on industry standards. Further, the projected recovery in excess of budgeted cost was not considered significant. Although the excess may not be a significant amount, service line rates should be calculated in a consistent manner to ensure fairness in the overall rate-setting process.

The FDIC's decision that the lower of the benchmark rate or budgeted rate should be used in selecting 2003 service line rates was based on the Legal Division's input that revenue should not be projected in excess of budgeted costs on any service line. However, DRR did not obtain the General Counsel's concurrence on the 2003 rate methodology, and the General Counsel has not formally opined as to whether using a service line rate that projects excess revenue would hamper the FDIC in the event of litigation related to administrative costs billed to the receiverships. Therefore, the FDIC does not yet have a formal opinion regarding a significant aspect of the rate-setting methodology.

Recommendations

We recommend that the Director, DRR, in establishing 2004 service line rates:

(1) Direct SLTs to calculate the service line rate using benchmark rates, budgeted rates, and other available information that provides a fair and reasonable cost recovery and to provide an analysis in the rate case of the difference between the projected recovery and the service line budget.

(2) Direct SLTs, in calculating service line rates, to conduct the analysis necessary to identify an appropriate reduction in budgeted service line costs for program maintenance activities.

(3) Request an opinion from the General Counsel regarding the appropriateness of projecting excess revenue in calculating service line rates, and once that opinion is received, issue guidance that instructs SLTs on how to apply the General Counsel's opinion in the rate-setting methodology.

FINDING B: OTHER SERVICE LINE RATE-SETTING MATTERS

Certain rate-setting matters in addition to those involving the FDIC's service line rate methodology warrant management's attention. Specifically, SLOs have not been able to effectively monitor their respective service lines using the Service Costing System to conduct variance analyses of budgeted and actual workload and forecasted and actual billing amounts. Ineffective monitoring occurred because cost model data in the Service Costing System needed for the SLOs to perform variance analyses are inaccurate and in a format that does not facilitate use. Additionally, the SLTs have not received training in the use of the Service Costing System Cost Module. Consequently, SLOs have not proposed service line rate adjustments when cost variances have occurred due to lower than expected workload.

Variance Analysis and Service Costing System Reports

SLOs have not conducted variance analyses of their respective service lines as prescribed by the FDIC's *Budget and Business Planning Procedures* to determine variances between budgeted and actual workload and forecasted and actual billing amounts. The expenses billed to receiverships are based on the actual workload within each service line multiplied by the approved service line rate. However, costs to the FDIC for work of the respective service lines relate primarily to salaries and compensation, which are generally fixed costs. Therefore, variances between receivership billings and actual costs will increase to the extent that actual workload differs from projected workload. For example, the rate set for the Asset Claims service line is based on a projected 2003 workload of 3,331 claims multiplied by the approved rate of $315 per claim for a projected recovery of $1,049,265. However, as of September 30, 2003, only 652 asset claims had been processed, and only $205,380 ($315 times 652) had been billed on this service line in comparison to the total actual cost of $2,329,067 reported in the Service Costing System.

To ensure that variances between actual costs and receivership billings can be monitored, the FDIC's *Budget and Business Planning Procedures* provide that service line workload and expense information from the Service Costing System should be available monthly to SLTs. However, DOF did not input this information into the Service Costing System Cost Model until May 2003 because of ongoing enhancements to the Service Costing System. Further, the actual expense data that were input as of May 2003 were not accurate. Since May 2003, DOF and DRR have been working together to improve the Service Costing System reporting format and to ensure accuracy of the data. However, as of September 30, 2003, work to resolve data and report format issues was still in progress. Consequently, SLTs have been unable to perform effective workload and expense variance analyses of their respective service lines. As of September 30, 2003, receivership billings totaled $59,643,670 in comparison to actual costs of $153,919,414 as recorded in the Service Costing System for the Receivership Management Program.

Service Costing System Training

A lack of SLO training in use of the Service Costing System also may have negatively affected monitoring of the service lines. Only 5 of the 11 SLOs indicated that they had attempted to access the Service Costing System to manage their respective service lines. The primary reason

SLOs gave for not accessing the Service Costing System was that they had not attended training in use of the system and/or service line reports. Training in use of the Service Costing System was provided by DOF prior to 2003; however, most of the current Service Line Owners had not attended those training sessions. The SLOs who had accessed the Service Costing System found the data in service line reports to be either inaccurate or in a format that was not useful for the analysis necessary to manage their respective service lines. The SLOs indicated that Service Costing System training would facilitate their ability to monitor their respective service lines once the formatting and data accuracy deficiencies are corrected.

Recommendations

We recommend that the Director, DRR:

(4) Ensure that service line cost data necessary for SLOs to monitor service lines are available and that adjustments can be made to receivership billing records in a timely manner.

(5) Provide training to SLOs, in coordination with DOF, on use of the Service Costing System Cost Model and/or other service line data made available upon completion of ongoing efforts to resolve data and report formatting issues.

CORPORATION COMMENTS AND OIG EVALUATION

On January 12, 2004, the DRR and DOF Directors provided a joint written response to the draft report. The response is presented in Appendix III to this report. In their written response, DRR and DOF management concurred with each of the recommendations. These recommendations are considered resolved but will remain undispositioned and open until we have determined that agreed-to corrective actions have been completed and are effective. The responses to the recommendations are summarized below along with our evaluation of the responses.

Recommendation 1: Direct SLTs to calculate the service line rate using benchmark rates, budgeted rates, and other available information that provides a fair and reasonable cost recovery and to provide an analysis in the rate case of the difference between projected recovery and the service line budget.

DRR agrees with this recommendation. DRR stated that it considered all available information, including benchmarks and budgeted rates, for setting 2003 billing rates. In its rate-setting analysis for 2004, DRR will document more clearly in its cases an analysis of the difference between projected recovery and the service line budget for its various rate options. DRR expects to complete this process by March 31, 2004.

This recommendation is resolved but will remain undispositioned and open until we have determined that agreed-to corrective action has been completed and is effective.

Recommendation 2: Direct SLTs, in calculating service line rates, to conduct the analysis necessary to identify an appropriate reduction in budgeted service line costs for program maintenance activities.

DRR agrees with the need to identify an appropriate reduction in budgeted service line costs for program maintenance activities. However, the joint response states that it is not currently possible to accurately estimate an appropriate deduction from service line budgets for program maintenance activities. According to FDIC management, as the Corporation moves into monitoring and capturing costs at the activity level, it will then be able to more accurately estimate a proper deduction for program maintenance costs. This will be possible with the implementation of New Financial Environment (NFE) cost management. In the interim, pending NFE cost management implementation, by December 31, 2004, DRR and DOF will explore options for estimating the costs of these activities and determining reasonable adjustments for such costs.

We accept management's position and proposed timing for DRR and DOF to explore options for estimating program maintenance costs. This recommendation is resolved but will remain undispositioned and open until we have determined that agreed-to corrective action has been completed and is effective.

Recommendation 3: Request an opinion from the General Counsel regarding the appropriateness of projecting excess revenue in calculating service line rates, and once that opinion is received, issue guidance that instructs SLTs on how to apply the General Counsel's opinion in the rate-setting methodology.

In conjunction with its 2004 rate-setting analysis, DRR will consult with the Legal Division on its proposed rates and obtain an opinion regarding the appropriateness of projecting excess revenue in setting a billing rate. DRR expects to complete this process by March 31, 2004.

This recommendation is resolved but will remain undispositioned and open until we have determined that agreed-to corrective action has been completed and is effective.

Recommendation 4: Ensure that service line cost data necessary for SLOs to monitor service lines are available and that adjustments can be made to receivership billing records in a timely manner.

DRR is currently working on establishing a process where cost data will be supplied to SLOs on a monthly basis. This will enable SLOs to monitor their service lines more closely and recommend billing adjustments in a timely manner. DRR expects to complete this process by June 30, 2004.

This recommendation is resolved but will remain undispositioned and open until we have determined that agreed-to corrective action has been completed.

Recommendation 5: Provide training to SLOs, in coordination with DOF, on use of the Service Costing System cost model and/or other service line data made available upon completion of ongoing efforts to resolve data and report formatting issues.

DRR is currently working on establishing a process where billing and cost data will be provided to SLOs on a monthly basis. This information will come from a variety of data sources and will provide SLOs with the ability to monitor closely the performance of their service lines. As soon as the reports are available, DRR, in conjunction with DOF, will conduct training to explain the reports and what is expected of SLOs in monitoring their service lines. DRR expects to complete this process by June 30, 2004.

This recommendation is resolved but will remain undispositioned and open until we have determined that agreed-to corrective action has been completed and is effective.

Appendix IV contains a summary chart of management's responses to the recommendations in this report.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of the audit was to assess the adequacy of the FDIC's process for developing 2003 Service Line Rates for the Service Costing System. Specifically, we determined whether 2003 service line rates were fair and reasonable, accurately calculated, and adequately supported. Our audit scope included service line rates established for calendar year 2003. We performed our work from May through November 2003 in accordance with generally accepted government auditing standards. To accomplish our objectives, we reviewed the following:

- 2003 Service Line Rate Cases
- FDIC Budget and Business Planning Procedures
- Service Costing System Cost Model System Users Manual
- FDIC Service Billing and Payment Procedures Users Manual
- Service Costing 2002 Rates for the Receivership Management Program
- Statement of Work for the APQC contract related to developing 2003 Service Line Benchmark Rates
- APQC Reports issued from March 2002 to March 2003

We interviewed SLOs in DRR and the Legal Division, Legal Division Counsel, DOF and DRR managers and staff members involved in the service line rate-setting process, and the APQC Project Manager who worked on the 2003 rate-setting process for the FDIC. We reviewed, analyzed, and recalculated 2003 Service Line Rate Cases and supporting documentation, verified supporting documentation related to indirect cost allocations, traced budget templates to approved service line rate cases, and compared data used in calculating service line rates to actual expenses recorded in the Service Costing System.

Performance Management

To determine whether DRR had any performance measures that we should consider in this audit, we reviewed DRR's 2003 Strategic Plan and the FDIC's 2002 Annual Performance Plan. DRR's 2003 Strategic Plan does not include any measures related to the service line rate-setting process. Although the 2002 Annual Performance Plan lists goals for the Receivership Management Program, none are directly related to the service line rate-setting process. However, the Annual Performance Plan includes the following as a major initiative: "During 2003, receivership management personnel will examine those areas in which FDIC costs significantly exceed benchmarks and, where necessary, implement appropriate cost-reduction measures to address those cost differentials." The Budget and Business Planning procedures drafted during 2003 include procedures to examine areas in which costs significantly exceed benchmarks and to implement cost-reduction measures. The procedures had not been completed at the time of this audit.

Reliance on Computer-Generated Data

We relied on computer-processed data that we determined to be sufficiently reliable for the purposes of this audit. The data were processed by commercial-off-the shelf software, including Microsoft Excel, Microsoft Access Database, Pillar, and Metify. Although we did not perform specific tests to determine the reliability of computer-processed data, we recomputed data related to budget rate calculations that had been processed using the Metify software and noted no exceptions.

Internal Management Controls

The Director, DOF, and the Director, DRR, are responsible for setting service line rates. During our review, a directive was in draft to establish procedures for planning and managing service line expenses, including the development and implementation of service line rates. We considered the procedures in our audit work and tested compliance with them to the extent possible. Certain controls related to conducting variance analyses had not been implemented due to Service Costing System enhancements that were still in process. These enhancements need to be completed for internal management controls to be effective.

Summary of Prior Audit Coverage

On March 31, 2003, the OIG issued a report entitled, *The Division of Resolutions and Receiverships' Controls Over Data Input to the Service Costing System* (Audit Report No. 03-027). The report identified data quality issues related to the accuracy and completeness of data used to update the Service Costing System and the need for additional controls to adequately validate and verify data in systems that update the Service Costing System. As of September 30, 2003, DRR and DOF had completed corrective action on two of the report's seven recommendations and were taking corrective actions to resolve the remaining recommendations.

Pertinent Laws and Regulations

Federal Deposit Insurance Act

12 U.S.C. § 1821(d)(11)(A) Depositor Preference

Subject to section 1815(e)(2)(C) of this title, amounts realized from the liquidation or other resolution of any insured depository institution by any receiver appointed for such institution shall be distributed to pay claims (other than secured claims to the extent of any such security) in the following order of priority: (i) Administrative expenses of the receiver.

12 C.F.R. § 360.3 Priorities

Unsecured claims against an association or the receiver that are proved to the satisfaction of the receiver shall have priority beginning with administrative expenses of the receiver, including the costs, expenses, and debts of the receiver. Under the provisions of section 11(d)(11) of the Act (12 U.S.C. §1821(d)(11), the provisions of this §360.3 do not apply to any receivership established and liquidation or other resolution occurring after August 10, 1993.

12 C.F.R. § 360.4 Administrative Expenses

The priority for "administrative expenses of the receiver," as that term is used in section 11(d)(11) of the Federal Deposit Insurance Act (12 U.S.C. §1821(d)(11)), shall include those necessary expenses incurred by the receiver in liquidating or otherwise resolving the affairs of a failed insured depository institution. Such expenses shall include pre-failure and post-failure obligations that the receiver determines are necessary and appropriate to facilitate the smooth and orderly liquidation or other resolution of the institution.

FDIC RECOVERY PRINCIPLES

As applied to recoveries from receiverships:

1. Applied consistently to all costs, costs are non-recoverable from receiverships if related to Corporate responsibilities and separate from the expenses which are "… necessary and appropriate to facilitate the smooth and orderly liquidation or other resolution of the institution."

2. Costs are not recoverable from receiverships if related to maintaining the readiness of the Corporation to discharge its insurance function.

3. Consistent with prudent application, costs are not recoverable from receiverships if they are associated with managing imbalances (for example, staffing imbalances).

4. Costs are not recoverable if they are related to public policy functions which provide no tangible benefits to individual receiverships.

5. Costs are not recoverable from receiverships if they are systems or other capital-oriented expenses whose benefits will be realized in future periods, subject to the following conditions:

    a) the costs are below designated capitalization and depreciation/amortization thresholds with the future periods benefited extending significantly beyond the estimated remaining lives of the receiverships in existence at the time the costs are incurred such that there is substantively no cause-and-effect linkage with particular receiverships; or

    b) the costs are above designated capitalization and depreciation/amortization thresholds; yet, nonetheless fail to satisfy the requirement that there be a cause-and-effect basis existing at the receivership level (i.e., these costs will be capitalized; however, the related depreciation or rental charge will not be recovered from receiverships without a cause-and-effect linkage).

CORPORATION COMMENTS

FDIC
Federal Deposit Insurance Corporation
Washington, DC 20429

Office of the Director
Division of Resolutions and Receiverships

January 12, 2004

MEMORANDUM TO: Stephen M. Beard
Deputy Assistant Inspector General for Audits

FROM: Mitchell L. Glassman *Mitchell L. Glassman*
Director, DRR

Fred Selby *Fred Selby*
Director, DOF

SUBJECT: Response to Draft Report Entitled, *FDIC's 2003 Service Line Rates* (Assignment No. 2003-022)

Following is the response to recommendations made in the OIG's report, *FDIC's 2003 Service Line Rates.*

Recommendations:

(1) Direct Service Line Teams (SLTs) to calculate the service line rate using benchmark rates, budgeted rates, and other available information that provides a fair and reasonable cost recovery and to provide an analysis in the rate case of the difference between projected recovery and the service line budget.

DRR agrees with this recommendation. DRR did consider all available information including benchmarks and budgeted rates for setting its 2003 billing rates. In its rate setting analysis for 2004, DRR will document more clearly in its rate cases an analysis of the difference between projected recovery and the service line budget for its various rate options. DRR expects to complete this process by 3/31/04.

(2) Direct SLTs, in calculating service line rates, to conduct the analysis necessary to identify an appropriate reduction in budgeted service line costs for program maintenance activities.

DRR agrees with the need to identify an appropriate reduction in budgeted service line costs for program maintenance activities. However, it is not currently possible to accurately estimate an appropriate deduction from service line budgets for program maintenance activities. As the FDIC moves into monitoring and capturing costs at the activity level, it will then be able to more accurately estimate a proper deduction for program maintenance costs. This will be possible with the implementation of NFE cost management. In the interim, pending NFE cost management implementation, by 12/31/04, DRR and DOF will explore options for estimating the costs of these activities and determining reasonable adjustments for such costs.

(3) Request an opinion from the General Counsel regarding the appropriateness of projecting excess revenue in calculating service line rates, and once that opinion is received, issue guidance that instructs SLTs on how to apply the General Counsel's opinion in the rate setting methodology.

In conjunction with its 2004 rate setting analysis, DRR will consult with the Legal Division on its proposed rates and obtain an opinion regarding the appropriateness of projecting excess revenue in setting a billing rate. DRR expects to complete this process by 3/31/04.

(4) Ensure that service line cost data necessary for Service Line Owners (SLOs) to monitor service lines is available and that adjustments can be made to receivership billing records in a timely manner.

DRR is currently working on establishing a process where cost data will be supplied to SLOs on a monthly basis. This will enable SLOs to monitor their service lines more closely and recommend billing adjustments in a timely manner. DRR expects to complete this process by 6/30/04.

(5) Provide training to SLOs, in coordination with DOF, on use of the Service Costing System cost model and/or other service line data made available upon completion of ongoing efforts to resolve data and report formatting issues.

DRR is currently working on establishing a process where billing and cost data will be provided to SLOs on a monthly basis. This information will come from a variety of data sources and will provide SLOs with the ability to monitor closely the performance of their service lines. As soon as the reports are available, DRR in conjunction with DOF, will conduct training to explain the reports and what is expected of SLOs in monitoring their service lines. DRR expects to complete this process by 6/30/04.

cc: Michael MacDermott
Thomas Peddicord
James Seegers
Peter Hull
Giovanni Recchia
Carlos Fiol
Michael Duncan

MANAGEMENT RESPONSES TO RECOMMENDATIONS

This table presents the management responses that have been made on recommendations in our report and the status of recommendations as of the date of report issuance. The information in this table is based on management's written response to our report.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Monetary Benefits	Resolved[a] : Yes or No	Dispositioned[b] : Yes or No	Open or Closed[c]
1	In its rate-setting analysis for 2004, DRR will document more clearly in its rate cases an analysis of the difference between projected recovery and the service line budget for its various rate options.	March 31, 2004	N/A	Yes	No	Open
2	DRR and DOF will explore options for estimating budgeted service line program maintenance costs and determining reasonable adjustments for such costs.	December 31, 2004	N/A	Yes	No	Open
3	In conjunction with its 2004 rate-setting analysis, DRR will consult with the Legal Division on its proposed rates and obtain an opinion regarding the appropriateness of projecting excess revenue in setting a billing rate.	March 31, 2004	N/A	Yes	No	Open
4	DRR is currently working to establish a process where billing and cost data will be supplied to SLOs on a monthly basis. This will enable SLOs to monitor their service lines more closely and recommend billing adjustments in a timely manner.	June 30, 2004	N/A	Yes	No	Open
5	DRR is working on a process where billing and cost data will be provided to SLOs on a monthly basis. When the reports are available, DRR, in conjunction with DOF, will conduct training to explain the reports and what is expected of SLOs in monitoring their service lines.	June 30, 2004	N/A	Yes	No	Open

[a] Resolved – (1) Management concurs with the recommendation and the planned corrective action is consistent with the recommendation.
(2) Management does not concur with the recommendation but planned alternative action is acceptable to the OIG.
(3) Management agrees to the OIG monetary benefits or a different amount, or no ($0) amount. Monetary benefits are considered resolved as long as management provides an amount.

[b] Dispositioned – The agreed-upon corrective action must be implemented, determined to be effective, and the actual amounts of monetary benefits achieved through implementation identified. The OIG is responsible for determining whether the documentation provided by management is adequate to disposition the recommendation.

[c] Once the OIG dispositions the recommendation, it can then be closed.